No. 126, Original

In The
Supreme Court of the United States

STATE OF KANSAS,

Plaintiff,

v.

STATE OF NEBRASKA
and STATE OF COLORADO,

Defendants.

COLORADO'S EXCEPTION TO THE REPORT OF THE SPECIAL MASTER AND BRIEF IN SUPPORT OF EXCEPTION

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COLORADO'S EXCEPTION TO THE REPORT OF THE SPECIAL MASTER

The State of Colorado respectfully excepts to the Special Master's recommendation that the measure of damages may take into account Nebraska's gain.

Respectfully submitted,

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and STATE OF COLORADO,

Defendants.

BRIEF IN SUPPORT OF COLORADO'S EXCEPTION TO THE REPORT OF THE SPECIAL MASTER

QUESTION PRESENTED FOR REVIEW

Did the Special Master err in recommending that the Court award an additional $1.8 million to Kansas as disgorgement of Nebraska's gain?

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The State of Colorado submits this brief in support of its exception to the Report of Special Master William J. Kayatta, Jr. dated November 15, 2013 ("Report").

JURISDICTION

The State of Kansas invoked the Court's original jurisdiction under Article III, Section 2 of the United States Constitution and 28 U.S.C. § 1251(a)(1).

STATEMENT OF THE CASE

In this original action, Kansas seeks, among other things, a monetary remedy for Nebraska's breach of the Republican River Compact. Report at 1. Following lengthy evidentiary hearings, the Special Master finds no evidence that Nebraska deliberately opted for noncompliance. Report at 130. Instead, he finds Nebraska's efforts to comply were earnest and substantial enough to preclude a finding that this was a consciously opportunistic breach. Report at 130-31, 111 ("None of the foregoing is to say that Nebraska deliberately set out to violate the Compact."). Based on these findings, the Special Master concludes that "were this an ordinary breach of contract case, Kansas' reasonably foreseeable loss would provide the measure of damages." Report at 130.

Despite that conclusion, the Special Master makes the following recommendation to the Court:

> I conclude that the monetary award here should be in the amount of $5.5 million. This amount represents an award for the full amount of Kansas' loss, plus an additional amount of $1.8 million. That additional amount represents a disgorgement of the amount by which Nebraska's gain exceeds Kansas' loss.

Report at 179.

The recommendation is based on the following three conclusions. First, that an original action is "basically equitable in nature." Report at 103. Second, that fashioning an equitable remedy "rests entirely in the judicial discretion (though) not arbitrarily and capriciously, and always with reference to the facts of the particular case." Report at 104 (quoting *Texas v. New Mexico*, 482 U.S. 124, 131 (1987). Third, that "in keeping with this discretion [ ] the Court need not make an either-or selection between the measures of loss and gain." Report at 135.

SUMMARY OF ARGUMENT

Colorado believes the Special Master errs in recommending disgorgement of an additional $1.8 million above Kansas' $3.7 million loss. Damages should be limited to Kansas' loss.

Disgorgement is improper in this case for three primary reasons. First, it is improper because Nebraska's violation of the Republican River Compact was not intentional. The Special Master's award of disgorgement relies on cases involving intentional violations of statutory law. However, Nebraska officials did not deliberately violate the Compact. Instead, they tried – but failed – to comply. Upon learning of their failure Nebraska officials took steps to lessen the effects on Kansas. These actions are not the callous and deliberately opportunistic actions described in the cases cited in support of disgorgement. Therefore, consideration of the actions of Nebraska officials recommends against disgorgement.

Second, this Court previously approved the recommendations of Special Master Littleworth in *Kansas v. Colorado*, No. 105, Orig., which denied Kansas' request for disgorgement after Colorado's breach of the Arkansas River Compact. Special Master Littleworth rejected the request because he found Colorado officials had not intentionally violated the Arkansas River Compact. The facts of this case do not justify departure from Special Master Littleworth's reasoning or this Court's decisions approving his recommendations.

Third, even if Nebraska officials had intentionally violated the Compact, the decision to award disgorgement would be improper because the amount is not reasonably tied to a calculation of Nebraska's gain or Kansas' loss. Awarding Kansas an additional $1.8 million would result in a windfall. For these reasons,

damages should be limited to Kansas' loss, which the Special Master determined to be $3.7 million.

ARGUMENT

I. Disgorgement is an improper remedy for an unintentional breach of compact.

This is not the first action involving breach of an interstate compact in which Kansas has requested disgorgement. Report at 134-135. Kansas' previous request was denied because the breach of compact in that case was not intentional. *Id.* Following that reasoning here, damages should be limited to Kansas' loss.

In *Kansas v. Colorado*, No. 105, Orig., Kansas invoked this Court's jurisdiction to settle disputes between Kansas and Colorado involving the Arkansas River Compact. *Kansas v. Colorado*, 514 U.S. 673, 679 (1995). Kansas claimed, among other things, that well pumping in Colorado had depleted Arkansas River flows in violation of the Arkansas River Compact. *Id.* at 679-680. Kansas requested disgorgement of Colorado's gain resulting from the violation. Special Master's Second Report at 75, *Kansas v. Colorado*, No. 105, Orig. (Sept. 1997). Special Master Littleworth rejected Kansas' request and recommended instead that damages should be limited to Kansas' loss. Second Report at 80. That recommendation hinged on the following finding:

> I do not believe that Colorado officials thought they were sanctioning a compact violation in the well regulations that were established, or in their failure to adopt specific regulations to protect usable Stateline flows, or in the issuance of new well permits.

Id. (quoting Special Master's First Report at 169, *Kansas v. Colorado*, No. 105, Orig. (July 1994)). Special Master Littleworth concluded that "[t]he lack of willfulness behind Colorado's violation of the Compact serves to distinguish the cases cited by Kansas in support of [disgorgement]." Second Report at 80.

Many of the cases Kansas cited are the same cases Special Master Kayatta relies upon to support disgorgement. *Compare* Report at 132 *with* Second Report at 78-79, *Kansas v. Colorado*, No. 105, Orig. (discussing *Porter v. Warner Holding Co.*, 328 U.S. 395, 400 (1946); *SEC v. Patel*, 61 F.3d 137, 139 (2d Cir. 1995); *Commodity Futures Trading Comm'n v. American Metals Exchange Corp.*, 991 F.2d 71 (3d Cir. 1993)). Each of those cases is distinguishable from the case at hand. Furthermore, close examination of those cases reveals that "looking to upstream gain" would be inappropriate in this case. Report at 135 (quoting Special Master's First Report at 82, *Kansas v. Colorado*, No. 105, Orig.).

Those cases involved intentional violations of the law and sometimes criminal conduct. For example, in *SEC v. Patel* the defendant pled guilty to conspiracy to defraud the Federal Drug Administration ("FDA") and served 27 months in prison for insider trading.

61 F.3d at 139. Defendant falsified reports to the FDA in order to secure approval of a generic drug produced by his company, Par. *Id.* at 138. Defendant then sold 75,000 shares of stock in Par before the company publicly announced it was recalling the drug. *Id.* In *Porter v. Warner Holding Co.* the defendant demanded and collected rents in excess of the maximums allowed under the Emergency Price Control Act of 1942. 328 U.S. at 396.

In *Commodity Futures Trading Comm'n v. American Metals Exchange Corp.* defendants ran a complex scheme involving fraudulent purchases and sales of precious metals futures. 991 F.2d at 75. Defendants did not physically transfer metals but prepared offsetting paperwork transactions. *Id.* The defendants then used incoming customer funds to pay off existing customers who desired to liquidate their investments. *Id.* at 76. For their scheme, defendants faced multiple counts of fraud and securities violations. *Id.* at 75 n. 7.

Special Master Littleworth found the lack of willfulness behind Colorado's violation served to distinguish these cases. Special Master's Second Report at 80, *Kansas v. Colorado*, No. 105, Orig. Similarly, the behavior of Nebraska officials is easily distinguished from the callous and deliberately illegal behavior described in *Commodity Futures*, *Patel*, and *Porter*.

Special Master Kayatta finds that Nebraska's violation of the Compact was not intentional. Report at 111. He finds "no evidence that Nebraska

deliberately opted for noncompliance in 2006." *Id.* at 130. Instead, he finds they tried earnestly but failed to comply. *Id.* at 130-31. He states that Nebraska's "efforts in 2006 to reduce the scope of its ensuing noncompliance – albeit too late and too little – were earnest and substantial enough to preclude a finding that this was a consciously opportunistic breach." *Id.* at 130-31. In addition, he finds that "Nebraska's substantial expenditures in 2006-2008 on water to mitigate its noncompliance were not the actions of a party callous to the downstream ramifications of its conduct." *Id.* at 179. Moreover, he finds Nebraska presented a credible case that it "began turning over a new leaf in 2007 and thereafter, planning for compliance with more care and urgency." *Id.* at 180.

Unlike defendants in the cases discussed above, Nebraska officials tried but failed to comply with the Compact. Upon learning of their failure, Nebraska officials took steps to lessen the impact on Kansas. Nebraska officials then took additional steps to ensure future compliance. These actions distinguish this case from the callous and deliberately opportunistic actions described in *Commodity Futures*, *Patel*, and *Porter* Therefore, disgorgement is not a proper remedy.

II. This Court should follow its previous decisions limiting damages to Kansas' loss.

Special Master Kayatta notes that the Court itself has never addressed the question of the proper measure of damages in a case for breach of compact

apportioning water rights. Report at 133. While it is true that the Court has not discussed the issue, this Court twice approved Special Master Littleworth's recommendation that damages should be limited to Kansas' loss. *Kansas v. Colorado*, 533 U.S. 1, 6 (2001); *Kansas v. Colorado*, 522 U.S. 1073 (1998). The Court should follow its previous decisions approving those recommendations since both cases involve unintentional breaches of compact.

Special Master Littleworth first rejected Kansas' request for disgorgement in his Second Report. Second Report at 84, *Kansas v. Colorado*, No. 105, Orig. Kansas did not file any exceptions to that report. *Kansas v. Colorado*, 522 U.S. 1073 (overruling without prejudice Colorado's exceptions).

In his Third Report, Special Master Littleworth again recommended that damages be measured by Kansas' loss, rather than Colorado's gain. *Kansas v. Colorado*, 533 U.S. at 6. Again, Kansas did not take exception to that recommendation. *See id.* at 15. Instead, it took exception to the recommendation not to award prejudgment interest for any years before either State was aware of the Compact violations. *Id.*

This Court overruled Kansas' exception and several others from Colorado, partially sustained one objection by Colorado, and remanded the case to the Special Master for preparation of a final judgment consistent with its opinion. *Id.* at 20. Although the Court said nothing about disgorgement, in the context of the order, the Court's silence "implies

acceptance, not rejection, of the Special Master's underlying methodology." *See Kansas v. Colorado*, 543 U.S. 86, 98 (2004). The key to Special Master Littleworth's methodology was the conclusion that disgorgement is inappropriate where the underlying breach of compact was not intentional. This Court should not depart from that methodology here. Therefore, the Court should limit the amount of damages to Kansas' loss.

III. Disgorgement would result in a windfall to Kansas.

Even if Nebraska's violation had been intentional, awarding Kansas an additional $1.8 million would result in a windfall.

The Court's power to fashion an equitable remedy is limited. The remedy in this case may not be arbitrary or capricious. *Texas v. New Mexico*, 482 U.S. 124, 131 (1987). It should not result in a windfall to Kansas. *See* Second Report at 80, *Kansas v. Colorado*, No. 105, Orig. ("Moreover, while Kansas should be made whole with respect to past violations of the compact, it is also appropriate that the remedy not result in a windfall.").

Moreover, courts awarding disgorgement recognize that disgorgement should be used as a remedy, not as punishment. *Commodity Futures*, 991 F.2d at 78. The purpose of disgorgement is to "restore the status quo" and order the return of that which

rightfully belongs to the aggrieved party. *Porter*, 328 U.S. at 401. Therefore, Courts awarding disgorgement have been careful to limit the award to the amount of unjust enrichment. *Commodity Futures*, 991 F.2d at 78. If the amount of unjust enrichment cannot be reasonably approximated, then the amount of disgorgement must be correlated to measured loss. *Id.* at 79.

In this case, the award of an additional $1.8 million is arbitrary and would result in a windfall to Kansas. The Special Master did not calculate Nebraska's gain. Special Master Kayatta describes the difficulty in calculating Nebraska's gain and ultimately concedes that a precise calculation might require another hearing and additional evidence. Report at 172-178, 180. The Special Master is left to conclude only that Nebraska's gain was likely much larger than Kansas' loss. Report at 178. In support of his estimation, the Special Master cites a book titled *Guesstimation: Solving the World's Problems on the Back of a Cocktail Napkin*. Report at 179 n. 64. The Special Master then awards Kansas an additional $1.8 million. Report at 179.

Similarly, the amount of disgorgement is not correlated to Kansas' loss. The Special Master finds that $3.7 million "represents an award for the full amount of Kansas' loss." Report at 179. Therefore, the additional $1.8 million is not correlated to Kansas' loss; nor is it designed to restore the status quo or return that which belongs to Kansas. Instead, it results in an inappropriate windfall to Kansas.

Therefore, damages should be limited to Kansas' loss of $3.7 million.

CONCLUSION

Special Master Kayatta finds that Nebraska's violation of the Republican River Compact was not intentional. He also finds that Nebraska officials took steps to lessen the impact of their violation on Kansas and began planning with care and urgency to ensure future compliance. If this were an ordinary breach of contract case, damages would be limited to Kansas' loss. Similarly, if this were an ordinary case for breach of statutory law, damages would be limited to Kansas' loss. Furthermore, the facts of this case do not justify departure from this Court's previous decisions limiting damages to Kansas' loss. Therefore, the Court should limit damages in this case to Kansas' loss of $3.7 million.

Respectfully submitted on the 27th day of February 2014,

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